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No. 88-753 (3)

In The

Supreme Court of the United States

October Term, 1988

In Re: FCX, INC.;
Employer's Identification No. 560220040, Debtor

UNIVERSAL COOPERATIVES, INC.

Petitioner,

v.

FCX, INC.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Whether the debtor in a Chapter 11 bankruptcy case may surrender to its secured creditor, which has on the face of its proof of secured claim asserted a lien and right of offset, the equity certificates held as collateral by that creditor in full satisfaction of the creditor's secured claim against the debtor.

Whether the equity certificates proposed to be surrendered in satisfaction of the secured creditor's claim should be valued at their face value.

Whether in the context of this proceeding a formal post-confirmation plan modification procedure was necessary to avoid prejudice to the petitioner.

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Respondent, FCX, Inc.[1], is a bankrupt North Carolina agricultural cooperative winding up the affairs of its estate by liquidating its assets. It respectfully requests that this Court deny the petition for writ of certiorari

[1] Pursuant to Rule 28.1, FCX, Inc. states that it has no parent, subsidiaries or affiliates.

seeking review of the Fourth Circuit Court of Appeal's decision with respect to a contested matter raised by Universal in the bankruptcy court below.

STATEMENT OF THE CASE

Petitioner's statement of the case is incomplete in many material respects and stretches well beyond the record of this case. Therefore, respondent offers the following alternative statement of the case as essential background to fully understanding the reasons for denying the writ.

The Petitioner ("Universal") is a non-profit agricultural cooperative association organized under Minnesota law. A-13.[2] Universal's members, called patrons, are also cooperatives. *Id.* The Respondent ("FCX"). which was organized under the North Carolina Cooperative Marketing Act, has been a patron of Universal since Universal's formation in 1980 through the merger of two other cooperatives. *Id.* Earlier, FCX was a patron of one of Universal's predecessor cooperatives. In addition to marketing the products of its own members, FCX purchased farm supplies from Universal, as well as from other sources, for resale to its members. A-13.

In order to maintain its tax-favored status under federal and state law, Universal is required to distribute its annual net income to its members. *Id.* Universal historically has made patronage refunds in a combination of

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[2] All references to the Appendix filed with the petition will be referred to as "A-___".

cash and certificates of participation ("patronage certificates"). A-14. The total amount of the patronage refund to a given member is based on that member's proportionate share of Universal's total business for the year. *Id.* Pursuant to this tax scheme, Universal takes a deduction against income for the *total* amount of the patronage certificates, while each member reports as income, and pays taxes on, its individual share of this *total* amount. *Id.* Thus, patronage certificates are valued at face value for both purposes. *Id.* Universal also carries the patronage certificates at face value on its balance sheet. A-14, n.1.

Universal's Articles of Incorporation grant Universal a first lien on a member's patronage certificates as security for any indebtedness of the member to Universal. A-14. The Articles authorize Universal to redeem as a setoff in satisfaction of the lien only an equal *face valued* amount of these certificates. A-28, n.14. *See also* A-96. Since its formation, Universal has periodically redeemed the patronage certificates at face value on a first issue, first redeemed basis. According to Universal's Articles of Incorporation, the patronage refunds are designated as being "at all times" the property of the patron member and not of Universal. A-94.

FCX filed its Chapter 11 petition on September 17, 1985. A-14. Universal filed proof of its fully secured claim against FCX on November 1, 1985. A-14. In its proof of claim it indicated that it held FCX property, namely the patronage certificates, and that it relied upon "the lien and right of offset" in them to satisfy its claim against FCX. A-41-42. FCX holds unredeemed certificates in the

face amount of $1,116,129. A-14. The parties have stipulated that the balance due on Universal's claim as of June 1, 1987, was $621,471.14. A-15, n.2.

After several attempts to resolve issues raised over FCX's treatment of Universal's secured claim, FCX filed its notice of intent to abandon the collateral held by Universal which secured its $621,471.14 claim. A-83-85. Universal objected to this motion on the grounds that the abandonment would force Universal to redeem equity in contravention of its Articles of Incorporation and by-laws which state that such equity will be redeemed only in the discretion of the Board of Directors. A-86-87.

The bankruptcy court then held a hearing on the abandonment issue on June 1, 1987. A-15. The court raised a question at the hearing as to the appropriateness of abandonment in the circumstances and, by letter dated June 5, 1987, the court informed the parties that it believed plan modification rather than abandonment was the appropriate remedy. Judge Small stated in the letter that "I infer from Mr. Grabiel's [Universal's general counsel] letter that Universal would like me to address the substantive issue rather than prolonging that determination." A-88-89. Judge Small then informed the parties that "accordingly, I will proceed to decide the issue of whether FCX, through plan modification, may surrender a portion of the Universal patronage certificates to Universal in satisfaction of Universal's secured claim." A-89. He specifically asked the parties that "if I have misconstrued Mr. Grabiel's letter, please let me know immediately." A-89.

On June 9, 1987, the court was informed by FCX's counsel that "Mr. Grabiel and I agreed over the telephone to request that you decide the issue of whether FCX, through plan modification, may surrender a portion of FCX's patronage certificates of Universal to Universal in satisfaction of Universal's secured claim." A-90. FCX's counsel read the letter over the telephone to Mr. Grabiel prior to delivery upon which Universal's general counsel joined in the request. A-91.

Pursuant to the notice and hearing concerning offset of the certificates, and the request from both parties to rule on the plan modification issue, the bankruptcy court authorized FCX to turn over to Universal that amount of the patronage certificates, at face value, as was necessary to satisfy fully Universal's claim. A-39. The district court upheld this order, finding that the plan modification was supported by substantive bankruptcy law, that the certificates were properly valued at face value, and that the modification procedure while not strictly in compliance with Bankruptcy Code requirements, substantially complied with those requirements and, moreover, the parties had waived strict compliance. A-30-33. The Fourth Circuit affirmed in a carefully crafted and limited opinion. A-12-28. No creditor, other than Universal, has expressed any objection to or dissatisfaction with this plan modification.

The Fourth Circuit held that § 1123(a)(5)(D) supercedes the discretionary power over surrender of patronage certificates as conferred on Universal's board by its by-laws. A-20. It distinguished its opinion from, and thus harmonized with, the Eighth Circuit's decision in *In re Schauer*, 835 F.2d 1222 (8th Cir. 1987) by noting

that the Eighth Circuit decision did not involve § 1123(a)(5)(D), but rather involved § 363(b)(1) and § 704. A-20. As the Fourth Circuit noted, §§ 363 and 704 provide a means within the context of a bankruptcy proceeding for the exercise of a debtor's pre-bankruptcy rights to dispose of its property. A-21. Relying on *Collier on Bankruptcy*, the Fourth Circuit noted that in contrast § 1123(a)(5) empowers a bankrupt through the plan to propose actions notwithstanding pre-bankruptcy rights. A-21. The Fourth Circuit also agreed with the bankruptcy and district courts that Universal's procedural objections were meritless in light of the facts that (1) FCX's abandonment notice provided Universal and other creditors with notice of the essential nature of the modification ultimately affected, (2) a hearing was held on that issue attended by both FCX and Universal, and (3) Universal itself requested a decision after that hearing on the modification plan issue. A-23.

Finally, the Fourth Circuit agreed with the two other courts below that the "indubitable equivalent" value of the certificates was, in the context of this case, properly represented by their face value. A-26-28. Not only was this consistent with the tax and accounting treatment of the certificates and Universal's Articles with respect to offset of the certificates, but otherwise, the court noted, Universal could frustrate bankruptcy law by relying on its discretion under non-bankruptcy law to continually delay redemption to some unknown future date. A-27. The Fourth Circuit noted that its decision was limited to whether valuation of patronage certificates at face value in the circumstances of this case satisfies the indubitable equivalent standard of § 1129(b)(2)(A)(iii). A-28, n.18. It

left for the bankruptcy court after further hearing to decide whether § 1129(b)(1) is satisfied in that the plan is "fair and equitable." *Id.* Thus, Universal was given a further opportunity by the Fourth Circuit's opinion to establish whether forced redemption threatened its continued viability or the status of its members. *Id.*[3]

REASONS FOR DENYING THE WRIT

I. THE FOURTH CIRCUIT'S CAREFULLY CRAFTED DECISION NEITHER CONFLICTS WITH DECISIONS OF THIS COURT NOR CREATES A CONFLICT AMONG THE CIRCUITS AND IS CORRECTLY DECIDED.

In an effort to elevate the limited and fact specific decision of the Fourth Circuit to a level of such national prominence as to warrant Supreme Court review, Universal attempts to manufacture a conflict between the Fourth Circuit's decision and that of the Eighth Circuit in *In re Schauer*, 835 F.2d 1222 (8th Cir. 1987). While it is true that both the Fourth Circuit and Eighth Circuit decisions concern the treatment of a cooperative's patronage certificates in the context of a bankruptcy, the similarity ends there. As noted above, *Schauer* involved §§ 363 and 704 of the Bankruptcy Code. The Eighth Circuit in *Schauer* noted:

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[3] Indeed, the parties are now litigating this very question before the bankruptcy court. *FCX, Inc., debtor-in-possession v. Universal Cooperatives, Inc.*, Adversary Proceeding No. S-87-0177-AP (Bkr. E.D.N.C.).

> Sections 363(b)(1) and 704 do not expressly authorize the trustee to sell property contrary to the restrictions imposed by state and contract law. These sections are simply enabling statutes that give the trustee the authority to sell or dispose of property if the debtors would have had the same right under state law.

835 F.2d at 1225. The Fourth Circuit decision on the other hand involved § 1123(a)(5)(D), not considered by the Eighth Circuit. The opening clause of § 1123(a) was amended in 1984 to read that "notwithstanding any otherwise applicable non-bankruptcy law, the plan shall" provide adequate means to distribute the estate's property among those with an interest in such property.[4] By its plain language then, § 1123(a)(5)(D) overrides non-bankruptcy law restrictions on the distribution of collateral to satisfy claims secured by that collateral. *See* A-19-23. As *Collier* states "the alternatives set forth in § 1123(a)(5) are self executing. That is, the plan may propose such actions notwithstanding non-bankruptcy

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[4] As amended, § 1123(a)(5)(D) reads as follows:

> (a) Notwithstanding any otherwise applicable non-bankruptcy law, a plan shall –
>
> . . .
>
> (5) provide adequate means for the plan's execution, such as –
>
> . . .
>
> (D) Sale of all or any part of the property of the estate, either subject to or free of any lien, *or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate*. . . .

law or agreements." 5 Collier on Bankruptcy, ¶¶ 1123.01 at 1123-10. In sum, because the Fourth Circuit's decision in this case and the Eighth Circuit's decision in *Schauer* address substantively different provisions of the Bankruptcy Code, they cannot be in conflict.

Neither does the Fourth Circuit's decision conflict with any decisions of this Court. This Court in *United Savings Association v. Timbers of Inwood Forest*, 108 S.Ct. 626, 633 (1988) observed that under § 1129(b) a secured claimant has the right to receive under a plan the present value of his collateral - "thus requiring interest if the claim is to be paid over time." The Court specifically limited its observation by holding that:

> This entitlement arises, however, not from the phrase "indubitable equivalent" in § 1129(b)(2)(A)(iii), but from the provision of § 1129(b)(2)(A)(i)(II) that guarantees the secured creditor "deferred cash payments . . . of a value, *as of the effective date of the plan*, of at least the value of such [secured claimant's] interest in the estate's interest in such property."

108 S.Ct. at 633 (emphasis in original). Hence, contrary to Universal's representation, this Court has specifically held that the "indubitable equivalent" standard does not itself require that a creditor be compensated at present value, however that might be defined in the peculiar context of this case. Rather, the present value requirement of § 1129(b)(2)(A)(i)(II) applies only to cases involving "deferred cash payments."

Because the plan modification requires immediate transfer by FCX to Universal of the collateral which secures the debt owed to Universal, § 1129(b)(A)(i)(II) is not implicated.

Universal's attempt to introduce confusion with respect to the relationship between §§ 506(a) and 1129(b) similarly fails to raise this case to the level of national importance warranting Supreme Court review. Indeed, none of the three courts below refer to § 506(a) in determining the value to be placed on the certificates under the indubitable equivalent standard of § 1129. There was never a dispute under § 506(a) about the value of the certificates for purposes of determining Universal's secured status. The hypothetical question as to what the relationship between § 506(a) and § 1129(b) should be was raised for the first time by Universal in its petition. Even if this had been a question of substantial national importance, which petitioner has failed to demonstrate, the issue would not be ripe for review until such time as it is presented in connection with a lower court decision in which the issue was raised and addressed. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.13, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976) (respondents barred from raising a claim in this Court where they had not raised it below). *See also Rice v. Sioux City Memorial Park Cemetery, Inc.*, 349 U.S. 70, 74, 75 S.Ct. 614, 99 L.Ed. 897 (1955) ("'special and important reasons' [for review on certiorari] imply a reach to a problem beyond the academic or the episodic.").

Indeed, given the peculiar circumstances of this case, the unanimous decision of the courts below that the face value of the certificates constituted the indubitable equivalent of Universal's claim was entirely appropriate and just. Universal could not present the court with an objectively quantifiable present value of the certificates

because it contended that the certificates could only be redeemed at the Board of Directors' discretion, whenever they might choose to exercise that discretion. On the other hand, Universal took full advantage of the benefit of deducting from its taxes the face value of the certificates just as FCX was required to pay taxes on the certificates at their face value. Universal also took advantage of its lien on the face value of the certificates to assert fully secured status. What FCX proposed to surrender in this case are patronage certificates whose face value represents dollar for dollar real funds received by Universal from FCX's patronage and held by Universal over time without payment of any appreciation or interest to FCX.

The Fourth Circuit agreed with the bankruptcy and district courts that it would be inequitable to allow Universal to frustrate (by indefinitely delaying redemption of the certificates) the Bankruptcy Code's mandate to distribute property of the estate among those having an interest in such property. Hence, the Fourth Circuit concluded that face value, in the circumstances of this case, met the "indubitable equivalent" standard of § 1129. This decision, however, specifically left Universal free to argue that such a modification to the plan was not "fair and equitable," if Universal could demonstrate that forced redemption of its collateral threatened its continued viability or the status of its members. A-28 n.14.

II. THERE IS NO NEED FOR THIS COURT TO EXERCISE ITS EXTRAORDINARY SUPERVISORY POWERS IN THIS CASE BECAUSE UNIVERSAL WAIVED STRICT COMPLIANCE WITH PROCEDURAL REQUIREMENTS FOR PLAN MODIFICATION AND THE PROCEDURES FOLLOWED IN THE COURTS BELOW SUBSTANTIALLY COMPLIED WITH PLAN MODIFICATION REQUIREMENTS WITHOUT PREJUDICE TO ANY CREDITORS.

Universal takes the audacious position that this Court should exercise its extraordinary supervisory powers to delay plan modification by requiring the bankruptcy court to strictly comply with procedural formalities that Universal earlier waived. Because Universal itself asked the bankruptcy court "to address the substantive issue rather than prolonging that determination," it cannot now be heard to object to the fact that the bankruptcy court proceeded as Universal requested. Universal has not, and cannot, demonstrate any prejudice following from the procedures employed in the court below. As the Fourth Circuit made clear in its opinion, the key procedural requirements for plan modification were substantially complied with, and Universal was in no way prejudiced by the bankruptcy court's failure to follow the strict procedure which Universal had itself requested the court to abandon. *See* A-23-25.

FCX is clearly not attempting a piecemeal reorganization, as was the case with the property leases proposed in *In re Continental Air Lines, Inc.*, 780 F.2d 1223 (5th Cir. 1986) (cited by Universal in its petition at pp. 12-13). Even though it might not have been expressly stated in the confirmed plan that FCX intended to surrender collateral to Universal in satisfaction of its secured claim,

neither should this have come as a surprise to Universal which upon the face of its proof of claim had stated that it intended to rely on "its lien and right of offset." No objection has been made by FCX to the Universal claim. What FCX attempted and Universal resisted is not in any real sense a modification of the plan of reorganization confirmed in this case. But Universal encouraged Judge Small to go forward and decide the issue as he defined it. In so doing, Universal has waived any right that it might have to insist upon formal plan modification procedure.

What was authorized by the courts below is no part of a sinister plot against other creditors. Indeed, no creditor other than Universal has objected to the bankruptcy court's decision. It appears that Universal is the only FCX creditor which owns an equity interest that has resisted the notion of mutual setoff of equity against trade debt. Universal was given a fair opportunity to voice its objections and having lost three times, it is now simply casting about in search of yet another forum.

The Fourth Circuit's carefully crafted review of the procedures employed by the bankruptcy court and approved by the district court presents no issue appropriate for review on certiorari.

CONCLUSION

For the foregoing reasons, respondent respectfully submits that the petition for writ of certiorari should be denied.

This the 3rd day of January, 1989.

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